

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petitions	:	
of	:	
EAST END STUDENT TRANSPORTATION CORP. AND JOHN AND MARY MENSCH, AS OFFICERS ¹	:	DETERMINATION
for Revision of Determinations or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period March 1, 1976 through August 31, 1982.	:	

Petitioners, East End Student Transportation Corp., and John and Mary Mensch, as officers, 242 West Montauk Highway, Box 261, Hampton Bay, New York 11946, filed petitions for revision of determinations or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period March 1, 1976 through August 31, 1982 (File Nos. 801661, 801662 and 801663).

A hearing was held before Catherine M. Bennett, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York on January 8, 1990 at 1:15 P.M. and continued to its conclusion on August 2, 1990 at 9:15 A.M., with all briefs submitted by December 13, 1990. Petitioners appeared by Peter R. Newman, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Carroll R. Jenkins, Esq., of counsel).

¹The Division of Taxation conceded that Mary Mensch was not a "responsible officer" of the corporate petitioner; thus, any assessment issued to her as officer of East End will not be discussed herein.

ISSUES

I. Whether the statute of limitations is a bar to the notices of determination issued in this matter.

II. Whether the notices of determination were properly mailed.

III. Whether the Division of Taxation ("Division") properly determined that petitioners were liable for the sales tax on gasoline purchased for use in fulfilling a contract between the corporate petitioner and a school district.

IV. Whether the Division properly determined that petitioner John Mensch was liable as an officer for the tax due from the corporation.

V. Whether the Division properly determined that penalties should be imposed against the petitioners in this matter.

FINDINGS OF FACT

Petitioner East End Student Transportation Corp. ("East End") was a transportation corporation engaged in the business of furnishing bus transportation services to school districts for handicapped students. Petitioner John Mensch, during all periods in issue, was the president and chief operating officer of East End. The business was incorporated March 1, 1976.

One of the issues in the case deals with the provisions of a contract between East End and the William Floyd School District pursuant to which bus transportation services were provided. A memorandum introduced into evidence discussed a portion of an audit of the William Floyd Union Free School District as it related to these petitioners. It disclosed that the school district had been acquiring gasoline for East End and had reduced the total contract price by the amount of gasoline used by the transportation company. No sales tax was being paid on this gasoline. Thus, the audit of East End ensued.

Attached to the memorandum was an excerpt from the State Comptroller's report on the school investigation which disclosed the following details about the arrangement between the school district and petitioner:

"Gasoline Purchases For Bus Contractor

During the 1979-80 fiscal year, the school district was billed by a gasoline company for gasoline delivered to the bus company's garages. This arrangement was not part of the bid specification.

The district issued checks made payable to the bus company which the company endorsed and made payable to the gasoline company. These payments were deducted from regular contract payments.

During the 1979-80 fiscal year, the district was billed for 178,600 gallons of gasoline at a cost of \$165,130.00. Although a school district may purchase gasoline for its bus contractors, such agreement must be part of the contract. Under the method used the procedure may constitute a sale of gasoline by the district which would require that applicable federal and state taxes be paid to appropriate agencies.

The appropriate tax enforcement agencies have been notified."

At the commencement of the audit, a request was made for petitioners' books and records, including the general ledger, cash receipts and cash disbursements journals, for the period June 1, 1979 to May 31, 1982. Records were provided and reviewed by the auditor. The auditor discussed obtaining invoices with the accountant and was informed that those applicable to the early part of the audit period, i.e., 1979 and 1980, were not readily available. Later in the hearing, testimony revealed that as a result of an unrelated investigation of the William Floyd School District, some of petitioners' books and records had been subpoenaed and never returned to petitioners. As a result of not being able to obtain the source documentation to support disbursement entries, the auditor deemed the records inadequate. In order to analyze proper taxation of certain purchases, the auditor then chose a later month in the audit period when invoices were available, May 1982, and used it as a test month for the purpose of projecting any potential taxation over the entire audit period. His procedure consisted of reviewing the cash disbursements journal for the month and making a record of checks written, including the name of the payee and the expense account charged. The auditor then requested the invoice that corresponded to the particular check. Upon examination of the invoices, he would determine whether sales tax was paid where appropriate. Upon his examination of tire purchases for May 1982, he determined that no sales tax had been paid. He then totalled the tire purchases listed in the disbursements records for the entire audit period, June 1, 1979 through May 31, 1982, and

the amount of \$10,213.95 was calculated as purchases upon which no tax was paid. Petitioners submitted no evidence to the contrary.

The equipment rental account for the test period, May 1982, was also reviewed. When petitioners' accountant raised an objection to the use of a test period for this category, the auditor agreed to review the account by actual disbursements even though many invoices were unavailable. He found \$61,980.95 in purchases on which tax was not paid for the audit period.

The auditor also reviewed the auto maintenance account. Approximately 90.5% of the purchases tested for May 1982 failed to show tax as paid. The auditor thus applied that percentage to all the maintenance account expenses reported for the audit period. The total maintenance expense upon which no tax was paid was \$158,196.27.

Thus, the auditor concluded that, for the period June 1, 1979 through May 31, 1982, total expense purchases found subject to tax was \$230,391.17 resulting in tax due in the amount of \$16,310.95.

Fixed assets were examined separately for the audit period. Based upon missing invoices and invoices indicating no sales tax paid, the auditor determined that there were purchases of fixed assets in the amount of \$184,645.51 upon which no tax had been paid, resulting in tax due of \$13,074.17.

At the conclusion of the audit of expense purchases for June 1, 1979 through May 31, 1982, the auditor evaluated what he had observed while reviewing test period invoices and petitioners' records. It appeared to the auditor as though petitioners were purchasing items as "exempt" by using a Federal identification number in lieu of a properly issued sales tax number. As a result, he extended the audit to include the period March 1, 1976 through May 31, 1979. The auditor made a request for books and records covering this time frame; however, no books and records were produced. He ultimately estimated tax due of \$59,818.72 for the extended audit period from a projection of that determined for the original audit period.

Introduced into evidence were three resale certificates obtained from East End's suppliers. The vendors listed on all three certificates were automotive related companies: a

brake service company, Key Chrysler and Southhampton Tire Center. Two of them bore the alleged certificate of authority number 11-2390674 and were issued in blanket form in 1977. The other listed its identification number as 11-2432997 and was issued as a blanket certificate in 1981. All made reference to the purchaser as being East End, although one was actually listed as "Montauk Bus Co., Inc. DAB [sic] East End Student Transp.".

The Division offered into evidence an affidavit of an employee who independently reviewed the Division's records to determine the validity of the identification numbers being used by petitioner. In the statement, he identified 11-2390674 as the Federal registration number for East End and 11-2432997 as a withholding tax number. A third number was also mentioned; however, it did not appear on the resale certificates introduced into evidence. None of the numbers was a valid number for a registered vendor in New York.

John Mensch's testimony indicated that East End was not a registered vendor and that he neither signed the resale certificates nor authorized any employee to do so on East End's behalf. Mr. Mensch did not, however, deny having taken advantage of exempt purchases by the use of such certificates.

The primary portion of the audit involved the analysis of the gasoline purchases. The auditor testified that RAD Oil Co. ("RAD") provided the Division, upon request, with the gallonage of gasoline ordered by the school district. During June 1, 1979 through May 31, 1982, 511,000 gallons were purchased. Petitioners stipulated on the record that the number of gallons is not disputed. The delivery by RAD was drop shipped to East End's yard for service to the district. The school would draft a check to East End which would then endorse the check over to RAD in payment of such gasoline. Examples of such checks were introduced into evidence. Pursuant to the testimony of John Mensch, check number 11295 bears his actual endorsement and the other two are a signature stamp of his endorsement. It was suggested that the actual check endorsement be compared to the resale certificate signatures that Mr. Mensch asserts are not his or authorized by him.

The gasoline delivered between June 1, 1979 and May 31, 1982, the original audit

period, resulted in tax due in the amount of \$33,014.34. Since the contract with William Floyd did not begin until November 1978, the tax on gasoline purchases was not extended to a time prior to that date.

On September 20, 1984, six notices of determination and demands for payment of sales and use taxes due were issued, two each to East End Student Transportation Corp., Mary Mensch, as officer, and John Mensch, as officer. The assessments asserted the following liability:

<u>Period</u>	<u>Tax</u>	<u>Penalty</u>	<u>Interest</u>	<u>Total</u>
3-1-76 to 8-31-79	\$ 61,524.32	\$15,381.08	\$57,439.09	\$134,344.49
9-1-79 to 5-31-82	<u>67,172.65</u>	16,793.18	31,413.48	115,379.31
	\$128,696.97			

The notices of determination dated September 20, 1984 were mailed by certified mail, return receipt requested, to the corporate and individual petitioners. All signed return receipts were maintained by the Division indicating delivery, with one exception. Notice of determination number S840920004F, issued to John Mensch covering the period September 1, 1979 to May 31, 1982, though bearing the same mailing address as the other notice addressed to Mr. Mensch and the two addressed to Mary Mensch, was returned to the Division. The Division retained the returned notice. An examination of the envelope revealed the following: the postmark was September 20, 1984; it was in fact mailed certified, return receipt requested; and the Postal Service attempted delivery on what appears to be September 21, September 26 and October 6, 1984. It was stamped "unclaimed" by the Postal Service and returned to the Division (Suffolk District Office) on October 11, 1984.

On December 18, 1985, a Notice of Assessment Review was issued on each of the six notices, reflecting revisions by the Suffolk District Office and a recalculation of interest to January 10, 1986. The revised assessments asserted the following tax, penalty and interest due:

<u>Period</u>	<u>Tax</u>	<u>Penalty and Interest</u>	<u>Total</u>
3-1-76 to 8-31-79	\$ 53,596.96	\$79,200.86	\$132,797.82
9-1-79 to 5-31-82	<u>61,643.60</u>	59,487.97	121,131.57
	\$115,240.56		

After a conciliation conference, various adjustments also were made to the tax asserted as due. The resulting tax liability asserted (exclusive of penalties and interest) was \$88,033.06 as follows:

	<u>Additional Tax on School Gas</u>	<u>Additional Tax on Expenses</u>	<u>Additional Tax on Fixed Assets</u>	<u>Total Tax Due</u>
05/76	\$ 0.00	\$1,343.95	\$ 0.00	\$ 1,343.95
08/76	0.00	1,343.95	0.00	1,343.95
11/76	0.00	1,343.95	0.00	1,343.95
02/77	0.00	1,343.95	0.00	1,343.95
05/77	0.00	1,343.95	0.00	1,343.95
08/77	0.00	1,343.95	0.00	1,343.95
11/77	0.00	1,343.95	0.00	1,343.95
02/78	0.00	1,343.95	0.00	1,343.95
05/78	0.00	1,343.95	0.00	1,343.95
08/78	0.00	1,343.95	0.00	1,343.95
11/78	2,720.75	1,343.95	0.00	4,064.70
02/79	2,720.75	1,343.95	0.00	4,064.70
05/79	2,720.75	1,343.95	0.00	4,064.70
08/79	0.00	755.86	0.00	755.86
11/79	2,636.00	865.68	0.00	3,501.68
02/80	3,365.60	1,016.91	0.00	4,382.51
05/80	3,454.92	834.14	0.00	4,289.06
08/80	1,851.43	1,121.10	0.00	2,972.53
11/80	2,738.12	929.72	0.00	3,667.84
12/81	3,788.23	1,917.60	0.00	5,705.83
05/81	3,205.80	1,336.34	0.00	4,542.14
08/81	1,378.94	2,210.04	8,753.43	12,342.41
11/81	3,385.81	1,928.74	3,621.30	8,935.85
02/82	3,883.72	1,627.85	641.44	6,153.01
05/82	<u>3,325.77</u>	<u>1,766.97</u>	<u>58.00</u>	<u>5,150.74</u>
Totals	\$41,176.59	\$33,782.30	\$13,074.17	\$88,033.06

Petitioner John Mensch testified that the arrangement with respect to the gasoline being purchased by the district came about during 1979 when the economy was experiencing a gasoline crisis. He asserted that only companies with a fuel allocation could obtain an adequate fuel supply. School districts, however, did receive a special allocation. Petitioners claim that as a result of these restrictions the school district and East End reformed the contract so that the school district would be making the purchases of fuel for East End to fulfill its contract obligations. Mr. Mensch further stated that the district dealt directly with RAD and that the gasoline was delivered directly to the district. This continued for approximately 18 months. A

copy of the reformed contract was not provided.

The unavailability of petitioners' records was attributed to the fact that the records of the school district were subpoenaed by the District Attorney. These records included some of petitioners' records that were provided in cooperation with an investigation which resulted in an indictment against the Superintendent of Schools.

The audit file contained several newspaper articles printed by Newsday in February and March 1983 regarding the charges against the Superintendent of William Floyd. The last of these articles indicated that the accused was being "exonerated from the 37 counts having to do with school district matters." He pled guilty to three misdemeanors involving personal income tax evasion.

The corporate petitioner filed no sales tax returns for any portion of the audit period.

SUMMARY OF THE PARTIES' POSITIONS

The corporate petitioner does not contest the corporate liability for tax on repair and replacement parts for vehicles. Petitioners East End and John Mensch do set forth the following positions on the issues to be addressed:

(a) The statute of limitations bars the notices issued herein.

(b) East End asserts it is not liable for the tax on the gasoline since the contract between East End and the school district was reformed, the district took title to the gasoline, East End could only use that gasoline for transportation provided to the district and East End received no economic benefit from the contract reformation.

(c) No penalties should be asserted against petitioners in this matter, especially since the Division did not introduce any evidence to support a penalty.

(d) John Mensch should not be held liable for the assessments against East End because East End is not a vendor within the meaning of Tax Law § 1101(b)(8)(i). If East End was not a vendor required to collect tax, John Mensch cannot have any personal liability for such tax.

(e) The notices of determination were not properly mailed and the Division has not come forward with proof of mailing, thus, they must be cancelled.

The position of the Division on the various issues can be summarized as follows:

(a) The statute of limitations does not bar any of the assessments in issue since no sales tax returns were ever filed by East End.

(b) Petitioners are liable for tax asserted on purchases by East End of gasoline from the school district since they have not established otherwise and there is no provision in the Tax Law exempting such purchases merely because they were used to fulfill a contract with an exempt organization.

(c) Although John Mensch failed to receive one of the notices of determination, the validity of the notice is unaffected. At best he would be entitled to a hearing, which has already taken place.

CONCLUSIONS OF LAW

A. It is clear in this matter that no sales tax returns were filed by East End. Where no return is filed the tax may be assessed at any time (see, Tax Law § 1147[b]; 20 NYCRR 535.3). Thus, if determined that tax is due and owing in this matter, the statute of limitations will not bar the assessments.

B. Tax Law § 1147(a)(1) requires notices of determination to be mailed by registered or certified mail for a finding of proper mailing. Petitioners assert without merit that no evidence of proper mailing was introduced by the Division. The Division in fact maintained as part of its audit workpapers and file the return receipts for each and every notice in issue. These were included in the evidence presented at the hearing and there is every indication that all notices were mailed in accordance with the Tax Law.

The one notice mailed to John Mensch of which petitioners' representative questions the validity was also mailed properly by certified mail. The original notice in its mailing envelope was returned to the Division and is also contained in the audit file in evidence. The Postal Service attempted delivery on what appears to be three separate occasions. Other notices reached Mary and John Mensch at the same address. One can only assume from the evidence that the notice was deliberately ignored by Mr. Mensch who can not now claim that the notice

was not validly issued or mailed. The notices in this case were properly issued and mailed as clearly established by the evidence.

C. With respect to the gasoline purchases made by the school district, the memorandum described in Finding of Fact "2" adequately describes the arrangement between East End and the district. The substance of the transaction was such that the bus company was making the purchases of gasoline through the use of the district name. It was doing so because of the allocation problem resulting from the gasoline crisis. The essential facts of the memorandum are supported further by the testimony of both the auditor and John Mensch. Petitioners introduced into evidence checks to illustrate the payment procedures. These, too, correspond with the facts disclosed in the school district investigation. East End was purchasing the gasoline from RAD, through the district, for use in fulfilling its contract. The amount to be paid to East End pursuant to the contract with the school district was reduced by the amounts paid to East End for the gasoline purchases. Those checks were endorsed by East End over to RAD in payment for the gasoline. Petitioners assert that the contract was reformed and the district was purchasing the gasoline and providing it to the bus company for services to the district. Petitioners claim the reformed contract was unavailable along with many other records supplied in the investigation of the school superintendent. The testimony in support of these assertions is neither credible nor supported by any evidence. Even if the only copy of certain records had in fact been used in the district investigation, that inquiry has been essentially over since mid-1983. Many years have passed giving petitioners more than adequate opportunity to retrieve their records. No testimony or evidence of any such effort was presented. The facts could not be more clear. The issue thus remains whether East End is liable for sales and use tax on these purchases when it used the gasoline in services provided directly to the school district.

D. Tax Law §§ 1105 and 1101(b)(4)(i) in part require tax to be imposed on a retail sale defined in part as a sale of tangible personal property that is neither for resale nor as a component part of tangible personal property.

Section 1133(b) of the Tax Law establishes liability for the tax in pertinent part as

follows:

"Where any customer has failed to pay a tax imposed by this article to the person required to collect the same, then in addition to all other rights, obligations and remedies provided, such tax shall be payable by the customer directly to the tax commission and it shall be the duty of the customer to file a return with the tax commission and to pay the tax to it within 20 days of the date the tax was required to be paid."

The transfer of gasoline in this case was a retail sale of tangible personal property upon which sales tax was not paid. It is clear that East End was the ultimate purchaser of the gasoline, and in fact was the party making payment to RAD. Further, there is no provision in the Tax Law which exempts petitioners' purchases of gasoline due to the fact that it was used in providing transportation services to fulfill a contract with the school district, an exempt organization (see, Matter of Best Bus Company, Inc. and Bestway, Inc., State Tax Commission, April 21, 1986). Thus the Division properly determined that petitioners were liable for the tax on gasoline purchases made during the period in question to provide transportation services to William Floyd School District.

E. Tax Law § 1133(a) provides that every person required to collect tax imposed by Article 28 shall be personally liable for the tax imposed, collected or required to be collected under said article. Tax Law § 1131(1) defines "persons required to collect tax" or any "person required to collect any tax imposed by this article" as:

"every vendor of tangible personal property or services; every recipient of amusement charges; and every operator of a hotel. Said terms shall also include any officer, director or employee of a corporation or of a dissolved corporation...who as such officer, director or employee is under a duty to act for such corporation...in complying with any requirement of this article; and any member of a partnership."

The question presented in this case is whether John Mensch was an officer "under a duty to act for such corporation".

In 20 NYCRR 526.11(b)(1) and (2), the Division of Taxation recognizes that the personal liability of a corporate officer for unpaid sales taxes imposed on the corporation is a factual question in every instance. The resolution of whether an officer is under a duty to act turns on this factual determination.

In Vogel v. Dept. of Taxation and Finance (98 Misc 2d 222, 413 NYS2d 862), some of the facts to be examined were set forth as follows:

"Indicia of this duty would include factors which directly relate to compliance with Article 28, such as the officer's day-to-day responsibilities and involvement with the financial affairs and management of the corporation, his knowledge of such matters, the officer's duties and functions outlined in the certificate of incorporation and the bylaws, and the preparation and filing of sales tax forms and returns [citation omitted]. Furthermore, in situations involving closely held corporations, as in the present case, an officer's knowledge of the corporate affairs and his benefits received from corporate profits would be extremely important considerations."

F. Given John Mensch's position in the corporation as well as his knowledge of the day-to-day operations and responsibilities with respect to the business operations he was appropriately charged with the responsibility for the payment of the sales and use taxes in issue. He did not act as an officer in name only, but was directly involved in the operations and details of the management of the business. Sales and use taxes were required to be collected and paid on various transactions in this case. There is no question that Mr. Mensch's knowledge of the operations as indicated by his testimony, the holding of the corporate office and his assumption of responsibilities for all other aspects of the management of the business clearly indicate that he was under a duty to act for the corporation in complying with any requirement of Article 28, including payment of sales tax on corporate purchases (See, Matter of Laschever, Tax Appeals Tribunal, March 23, 1989.)

G. Tax Law § 1145(a)(1) imposes a penalty and interest on taxpayers who fail to timely file a sales tax return or pay the sales tax when due. The statute requires the Division to abate the penalty and interest if it determines that such delay or failure was due to reasonable cause. The grounds for reasonable cause are defined in the Division's regulations to include:

"[a]ny...cause for delinquency which would appear to a person of ordinary prudence and intelligence as a reasonable cause for delay and which clearly indicates an absence of willful neglect..." (20 NYCRR 536.5[c][5]).

The burden of showing that there was reasonable cause and that the penalty was wrongly assessed is on the taxpayer. The regulations also clearly provide that "[i]gnorance of the law, however, will not be considered as a basis for reasonable cause" (20 NYCRR 536.5[c][5]).

H. Petitioners have not established that they had reasonable cause for their failure to comply with the Tax Law. Petitioners offered no testimony or documentary evidence to support any consideration of abatement of penalty. A portion of the testimony with respect to petitioners' involvement with the school district conflicted with third-party source information placing Mr. Mensch's credibility in question. Petitioners did not show what steps were taken to ascertain their tax responsibilities when the gasoline was ordered in the name of the district. Petitioners made no apparent effort to retrieve the books and records provided for the investigation of the school district. In comparing the checks (with John Mensch's signature) used to pay RAD with the resale certificates which purportedly did not bear his signature, there is a striking resemblance between the check endorsement and the signature on the resale certificate to the brake service company. In addition, the use of improper identification numbers to take advantage of resale certificates was disclosed. If there were any cause for delinquency in this case, it was surely not absent willful neglect. The penalties are thus sustained.

I. Mary Mensch is relieved of any liability by virtue of the concession by the Division that she does not qualify as a responsible officer (see Footnote "1").

The petitions of East End Student Transportation Corp. and John Mensch are hereby denied and the notices of determination and demands for payment of sales and use taxes due dated September 20, 1984, as modified (see Finding of Fact "12"), are sustained.

DATED: Troy, New York

ADMINISTRATIVE LAW JUDGE